

Revocable vs. Irrevocable Trusts

Whether a creditor can reach assets in a revocable trust is a common question, and the general answer is revocable trusts offer no protection from creditors. However, if the trust is irrevocable, such protection is provided. The reason for this different treatment is illustrated in the recent case of *Dudek v. Dudek*.

In *Dudek*, the Court of Appeal reversed the decision of the trial judge, and held that the signing of the irrevocable Trust that specified a life insurance policy was an asset of the Trust, caused the Policy to become an asset of the Trust and under the control of the specified trustee immediately upon the signing. In other words, the Policy was no longer under the control of the grantor/settlor as it had been gifted to a Trust no longer owned by the grantor/settlor.

Petitioner David Dudek appealed to recover money distributed to the respondents in accordance with the beneficiary designation of the Genworth Life Insurance Policy that covered the life of J.D. Dudek, David's brother.

According to David, in late 2009, J.D. created and executed the J.D. Dudek Life Insurance Trust, an irrevocable life insurance trust that named David as the trustee, and beneficiary of the death benefit of \$1,000,000. David claimed the Policy is listed as an asset of the Trust, to be held and administered in accordance with the Trust's terms.

The Trust designates David and his sister as the residual beneficiaries of the Trust who would be entitled to the proceeds of the Policy.

J.D. prepared and submitted to the life insurance company the forms required by that company to change the ownership and beneficiary designations on the Policy in order to establish David, as trustee, as the sole owner and named beneficiary of the Policy.

David was unaware that not long after J.D. submitted the forms, the insurance company rejected the ownership and beneficiary designation forms because J.D. had altered some of his entries without initialing the changes. David was also unaware that J.D. had failed to file corrected forms with the life insurance company after he was notified of the insurance company's rejection of his submitted forms.

Further, David did not know that in 2016, J.D. submitted a new form to the life insurance company in which he purported to alter the beneficiary designation on the Policy to name the respondents as the beneficiaries of the Policy, or that the new form was accepted by the life insurance company.

After J.D. died, David submitted the Trust to the life insurance company and sought to obtain the proceeds of the policy. The life insurance company refused, and instead distributed the proceeds of the policy to the beneficiaries that it had on file, pursuant to the beneficiary designations that J.D. submitted in 2016.

David filed the Petition seeking an order directing the respondents to transfer the proceeds of the Policy to him as the trustee of the Trust.

The trial court concluded that the Trust had not been funded, and therefore, had not become a valid trust, as a result of J.D.'s failure to file documents with the life insurance company to change the ownership and beneficiary designations to correspond with the terms of the Trust document. In other words, the trial court concluded that no trust was ever created because J.D. never effectively placed the Policy into the Trust.

The Appellate Court held the trial court erred because the Petition alleged facts that could support a finding that the execution of the Trust document created an irrevocable trust, and constituted an effective inter vivos donative transfer of the Policy to David as trustee of the Trust. Given the irrevocable nature of the Trust and the language in the Trust document demonstrating J.D.'s intention to immediately transfer ownership of the Policy to David, upon execution of the Trust document, the Policy irrevocably became Trust property. As a result, J.D. had no ability to effectuate any further transfer of the Trust property to other parties.

The Trust stated that JD, as the Grantor, retained no right, title, or interest in any trust property. The Trust and all interests in it were irrevocable, and the Grantor had no power to alter, amend, revoke, or terminate any trust provision or interest. Schedule A of the Trust listed two assets to be held in the Trust: (1) one hundred dollars, and (2) the \$1,000,000 Policy.

After the insurance company distributed the proceeds to the respondents, David sent letters to the respondents notifying them that they had received the proceeds from the Policy to which they were not legally entitled because those proceeds were the property of the Trust. David asked the respondents to deliver to him, as trustee of the Trust, the Policy's death benefits. David did not receive payment from any of the respondents.

David filed his Petition seeking:

- (1) an order directing the transfer of Trust property from respondents to David, as trustee, pursuant to Probate Code section 850;
- (2) an order determining the proper beneficiaries of the Trust's assets pursuant to Probate Code section 17200;
- (3) a determination that the respondents had acted in bad faith in wrongfully taking, concealing, or disposing of property belonging to the Trust; and
- (4) a determination that J.D. had acted in bad faith in wrongfully taking, concealing, or disposing of the property of the Trust.

Respondents argued that David's claim should have been brought against J.D., alone, and they had no liability to the Trust because they are not signatories to the Trust, were not bound by the Trust and owed no duty or obligations to the Trust.

David contended that the trial court erred in concluding that J.D. failed to complete the steps necessary to create the Trust as required by Probate Code § 15200(b). According to

David, when J.D. executed the Trust, he forfeited his interest in and control of the Trust and its assets, so that J.D. did not have the right to change the beneficiary designation in November 2016. Because J.D. lost the right to change the beneficiary designation, David, as trustee of the Trust, may properly pursue a claim against respondents for recovery of the Trust's assets that respondents received, but to which they were not entitled.

Under the Probate Code § 15200, a trust may be created in one of five ways:

- (a) A declaration by the owner of property that the owner holds the property as trustee.
- (b) A transfer of property by the owner during the owner's lifetime to another person as trustee.
- (c) A transfer of property by the owner, by will or by other instrument taking effect upon the death of the owner, to another person as trustee.
- (d) An exercise of a power of appointment to another person as trustee.
- (e) An enforceable promise to create a trust."

The Petition alleged that J.D. sought to create the Trust pursuant to subdivision (b) of section 15200— through the transfer of property by the owner during the owner's lifetime to another person as trustee.

The essential necessary elements of a valid trust are:

- (1) a trust intent (Probate Code § 15201);
- (2) trust property (Probate Code § 15202);
- (3) trust purpose (Probate Code § 15203); and
- (4) a beneficiary (Probate Code § 15205)

Except for trusts that are created by declaration or by contract, a transfer of the intended trust property is required for the creation of an express trust, whether during life or at death. The effectiveness of a transfer for the purposes of establishing an inter vivos trust, however, is determined by the rules that govern the making of gifts. A gift is a transfer of personal property, made voluntarily, and without consideration. A donative transfer is a gratuitous transaction. It can be inter vivos or testamentary

Three things are necessary for a valid gift:

- (a) There must be an intent, on the part of a donor having capacity to contract, to make an unconditional gift.
- (b) There must be an actual or symbolical delivery, such as to relinquish all control by the donor.
- (c) The donee must signify acceptance, except where it may be presumed.

With respect to personal property, a donative transfer that is intended to be completed during the donor's lifetime may be completed in one of two ways: either by the actual delivery of the personal property at issue to the intended donee *or* through the use of a document of donative transfer.

The Petition alleged that J.D. intended to make a donative transfer of the Policy into the Trust, such that the Policy would be owned by David as Trustee, through the use of a document of donative transfer.

An inter vivos donative document may transfer any type of personal property, whether tangible or intangible, *including contract rights such as those embodied in a life-insurance policy*. An inter vivos donative document is a writing signed by the donor that (a) identifies the donor and donee, (b) describes the subject matter of the gift, and (c) specifies the nature of the interest given.

The Trust document attached to the Petition appeared to meet all of the necessary elements of a donative transfer document. Specifically, the Trust document evidenced that J.D. had the intent to effectuate an immediate, complete and irrevocable transfer of ownership of the Policy to David, as trustee.

Thus, although J.D.'s failure to complete the forms according to Genworth's requirements protected Genworth from claims made against it by individuals other than those who were identified on the forms that it had on file, the failure to properly complete the forms could not invalidate or revoke the irrevocable gift that J.D. had previously effectuated to David, as trustee of the Trust. Once J.D. made a donative transfer of the policy to David, J.D. no longer owned the Policy, even if Genworth was unaware of this.

Thus, although J.D.'s later decision to name the respondents as beneficiaries through the change of beneficiary forms provided by Genworth may have protected Genworth from claims for damages made by individuals or entities not identified on the forms on the ground that it had wrongfully distributed the proceeds, David's naming the respondents as beneficiaries on the Genworth documents did nothing to alter David's legal right to possess the Policy, and, ultimately, its proceeds, as trustee of the Trust.

Once an irrevocable trust is created and a valid transfer of property is made to the trust, the settlor no longer has any right to possess or otherwise dispose of the property placed in an irrevocable trust, such that that individual has no ability to reverse course or change his/her mind later.

David may name the respondents in his Petition, and the respondents are proper parties to the action brought pursuant to the Probate Code. If David can establish the facts alleged in the Petition, then it would be clear that J.D. created an irrevocable trust, and properly funded it, when he delivered to David the transferring document (i.e., the Trust document itself, which included the transferring language).

If the Trust was created, then David's entitlement to the proceeds of the Policy that was an asset of the Trust would be established, and he would be able to seek the court's assistance in having those proceeds conveyed to him in his capacity as trustee.

LESSONS:

1. The effect of an irrevocable trust is different from that of a revocable trust, and the grantor/settlor should carefully consider the nature of the trust being created.
2. After signing the living trust, it should be funded with assets by transferring the assets into the trust (e.g., deeding real property to the trustee of the Trust).
3. If the trust is irrevocable, and the language in the trust document demonstrates the intention to immediately transfer ownership of the assets to the trustee, upon execution of the trust document, the asset may irrevocably become trust property.
4. An irrevocable trust prevents the grantor from making any changes to the trust after it is signed, and consideration should be given to making Trust revocable so it can be amended and revoked.